ROUGH TRANSCRIPT NOT FOR PUBLICATION

THE ECONOMICS OF MILTON FRIEDMAN

by

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A lecture given at NYU Loeb Student Center

April 21, 1970

Thank you very much Percy. It's a pleasure being here again.

I'm not quite of Milton Friedman's generation. That's a petty point. I'm a little bit younger than he is. Insert that into the record.

I think a lot of people seem to be afflicted with an excess of "Friedman" worship, so I'm not going to stress the good points that Friedman has made in the past few years. I think most people are familiar with them. I might even be so unkind as to paraphrase Friedman's mentor, Henry Simon~~d~~s. Simon~~d~~s wrote an article about Al- ~~bert~~ vin Hansen one time, Hansen being a top left-wing Keynesian in the past years, now more or less retired. He began an article saying, "I come to bury Hansen, not to praise him." I could say the same thing about Friedman tonight.

In the first place, one of the problems with the press in general is that the press has a very short memory. Somebody comes up with an idea and if nobody has said it for the last three years, it is immediately hailed as a great new idea, a great new discovery. And the same thing has happened to Friedman. Almost everything he says is a complete reincarnation of what, for example, Irving Fisher said 40 years ago, 30 years ago. But since the collective memory of the press, even of the economic profession, is very short, nobody points this out. So Friedman's discovery of all sorts of so-called "laws" are simply rediscoveries or restatements of what Fisher said in a clearer fashion 40 years before.

For example, there is a famous law that Friedman was supposed to have discovered a year or two ago -- that the interest rate rises during an inflation, especially during the later stages of inflation because as prices are going up, they have a discount, a positive price discount, a premium rather, a positive price premium on interest rate to account for the prices rising. So that if the creditor is demanding a 6% return, for example, and prices are going up at 6% a year obviously you have to ask a lot more than 6% to overcome the inflation. So Friedman is supposed to have made this great new discovery and the economics profession now is sort of in a tizzy about that. Of course, Fisher said exactly the same thing about 40 or 50 years ago, and Mises has said the same thing in his work, and so forth. But, as I say, the collective memory of the press and the economics profession is very, very short. As I will point out later on, this is also true of Friedman's general theory about money and the business cycle. It's essentially Fisher, rediscovered and with a lot of statistics added on to it.

I'm going to talk tonight essentially about the political rather than the methodological critique of Friedman. I could say a lot about the methodology, but in this sort of gathering I think that we can stress the political economy aspect.

I just want to say in passing that Friedman is probably the outstanding proponent in methodology of an extreme variant of logical positivism. In other words, he is the major opponent of Professor Mises' methodology, so to speak. Friedman is so extreme that he says that a theoretical assumption not only does not have to be proven, it can even be false, and still be a correct theory. It doesn't matter if the assumptions are false, he says, as long as the predictions are correct which are based on these false assumptions. This is an extreme version of positivist methodology. In fact this is the exact counter to everything that praxeology holds dear. But as I say, I don't want to talk about methodology tonight. I just want to mention that in passing.

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First -- and I'm not going to deal too much with this either -- there is the whole field of monopoly and competition. Now it's true that in practice Friedman has come a long way from the original Henry Simonds position. The original Henry Simons position was written in a really screwball book -- I think in 1934 -- called "Positive Program for Laissez Faire" which I recommend everybody read, because it really states very clearly the Chicago School position, the political position of the Chicago School. Essentially, what Simonds said was that every corporation above the size of a small blacksmith shop should be broken up, trust-busted, by the government and reduced down to blacksmith-ship size so that we can all have perfect competition, so we can enjoy the benefits of "perfection" in competition. This, I say, was the original Chicago position. They've come quite a way from that, happily. Friedman today doesn't take this position. He recognizes the major source of monopoly today is government privileges, government regulation and subsidies, and so forth. But still there's a canker there, the theory is still there, the theory being the Chicago position that "perfect competition" is better than imperfect -- in other words, that a firm of a constant demand curve, a horizontal demand curve, is somehow better and superior and more pure, more moral than a firm that faces a falling demand curve. So this idealization of perfect competition still remains even though it's played down now in practice in the Friedman position. It's still there to plague us in the future because sometime in the future we'll again hear the cry from the Chicago School that such and such a corporation should be broken up because it's too big and it's facing a falling demand curve, and so forth. We can expect it at any time. Let's put it that way. Just as Professor Stigler, Friedman's most distinguished associate, said about fifteen years ago, that U. S. Steel should be broken up into its constituent parts because it was monopolistic. I don't know if he still says that -- he's come a long way too in the last 20 years -- but the theoretical structure still remains. But I don't want to deal too much with monopoly competition either because this again is more a theoretical than political position at the present time.

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Let's get to Friedman's big argument for government intervention in general which is the so-called "neighborhood effect." I particularly want to talk about the external benefit part of neighborhood effect, in other words, the idea that if two or three people are doing something which another set of people are benefitting from but aren't paying for, this is a terrible, terrible thing and these people should be forced to pay for it. This is one version of it. And again in practice, Friedman doesn't push this to a great extent. He essentially says, well, this is really limited. We limit the application of this to urban parks, Central Park which should be governmental because you can watch the park and not pay for it and that's a terrible thing. You should be forced to pay for it.

And also education which is, of course, a very big item. Friedman's in favor of government's being up to its neck in education for the same reason. But in general he restricts it [the application of the neighborhood effect doctrine] more or less to those areas. My contention is that the same argument can be used for almost anything, to justify almost any act of government intervention whatsoever and that Friedman is really unjustly limiting it, once you accept the argument.

One of my favorite examples which I always use in class is that people, men in particular, are enjoying the sight of girls wearing miniskirts -- of course this is on the way out -- up til now they've been enjoying the sight of girls wearing miniskirts, and they have been enjoying it without paying for it. In other words, here we have an esthetic benefit, a psychic benefit, which they are not being forced to pay for. The Friedmanite argument should be that we should all be taxed to pay girls to wear miniskirts, and this would iron out the external benefits and smooth out the "neighborhood effects."

Similarly, this goes for almost anything else. If one of us, for example, becomes a wiser person by reading a great book or something, by reading Socrates or whatever, he becomes wiser by this wisdom and then he benefits other people along the way and therefore they should be taxed and subsidized in reading Socrates and so forth and so on. It's almost infinite. This whole approach seems to me to be very peculiar. In the first place, it really means we should all wear sackcloth and ashes because we're all free riders. This is really an attack on the free rider. But we're all free riders on the discoveries of the past, the writings of the past, the technical inventions, the capital investment of everybody who's gone before us. We're all getting the benefits of this without paying for it, in a sense. Does that mean we we should beat our breasts and tear our hair and be taxed by somebody in order to somehow pay for this, in order to suffer for the benefits that we are enjoying. It's a very peculiar kind of theory. So what I'm really saying is that free riding, which Friedman is trying to attack here in the neighborhood effects, is really an essential part of civilization altogether. If we want to abandon free riding we really have to abandon the fruits of civilization.

Now when I have talked with Chicago-ites and Friedmanites about the miniskirt analogy, by the way, they admit that this is correct but they say they wouldn't push the theory that far. Why not? We talk about the role of logic in political policy and, of course, those of us in favor of logic, I think, have a point there.

There is another part of the theory, a sort of the other side of the coin of the free rider, is that if you can do something which will benefit other people and you're not doing it, they should be able to force you to do it. If you're not conserving copper, or something of that sort, this configuration will help people and they should be forced to do it.

My favorite analogy here is the case of the three guys who were playing in a string quartet. There was a fourth guy who could pay the cello but was sort of recalcitrant and didn't want to do it. And the theory then should say that they should be able to force him to play the cello because it would benefit all three of them. And, this again is a part of the neighborhood effect. I'm not saying Friedman says this. What I'm saying is that he should be saying this if he were a consistent neighborhood effect theorist.

So much for neighborhood effects. What I'm saying is this is Friedman's major argument for government intervention in almost any area that he thinks the argument applies, such as education.

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Okay, now to get to a point which I think is probably -- and this is of course a value judgment -- the single most disastrous economic idea ever invented. This is the idea of the negative income tax or the guaranteed annual income. Of course, here again is an interesting situation. Friedman coined the idea of the negative income tax, in other words a guaranteed minimum income floor FOR everybody. This became the inspiration for more radical schemes such as Robert Theobald and the Ad Hoc Committee of the Triple Revolution and also, of course, for Nixon's current welfare program.

The problem of the negative income tax is that it provides an income floor, BY <u>right</u> -- in other words, as a rightful cliam, as an automatic claim, upon production. It no longer becomes the sort of thing we have to go to the welfare department, sort of hat in hand and fill out a form and say you really deserve it, and if they don't think you do you have to argue about, which is sort of a degrading thing. Now it becomes automatic. You fill out your income tax form -- you say you have gotten less than the prescribed floor and you get the money in a couple of weeks.

Now what I'm saying here is that the present welfare system -- as crumby as it is, as bad as it is, as inept, as inefficient and as bureaucratic as it is, is precisely saved from disaster by its very ineptness, its very bureaucracy and its very inefficiency, because it means that the whole system of going on welfare is, in the first place, chaotic -- it is not automatic. In the second place, it is unpleasant. You have to go through all these tin horn bureaucrats to justify being on welfare and get inspected, and so forth. And this very unpleasantness provides an extremely necessary disincentive effect to prevent people from going on welfare. This, incidentally, is the original, the old 19th century laissez faire, liberal position. If you have to have welfare at all, it should be very, very unpleasant so as to discourage people from going on it.

The Friedman theory, in the name of efficiency and simplicity, and automaticity, and so forth, eliminates this very essential unpleasant feature and makes the thing automatic. What we have to realize is that there is a supply function -- or supply curve for going on welfare. Every empirical study of the thing has shown the quantitative importance of this. The supply function is essentially this: It is inversely proportional to the difference between (1) the prevailing wage rate in the area and (2) the welfare level. In other words, if the welfare level remains the same and the prevailing wage rate in the area rises, people start leaving welfare and start working because the difference between the money they can get from working and the money they can get from welfare increases -- this gap goes up. So they go off welfare and onto the payroll. If on the other hand, the welfare level goes up and the prevailing wage remains the same, then they start going on welfare because the amount of money they can get from working, which is generally a pain in the neck, decreases. So the incentive to go on welfare increases. This means that being on welfare is not somehow a divine act. In other words, it doesn't come from outside the system. Being on welfare is a supply function and it responds to different incentives and disincentives. And one of the incentives is the prevailing wage rate as compared to the welfare rate, the welfare payment rate.

The supply function of going on welfare is also inversely proportional to the "cultural disincentive," shall we put it that way? In other words, the stronger the cultural aversion, the cultural resistance to being on welfare, the less the people will tend to be on it. This accounts, for example, for the reasons why there are much less rural poor going on welfare than urban poor, even though rural poor are just as poor, if not even more so. In the rural area there is a stigma, a general social stigma in a neighborhood for going on welfare. It is generally opposed and bitterly so, especially by the people who are paying for it, in other words the local folk who are working and paying taxes for it. So because of this stigma, far fewer people go on it. In urban areas the stigma tends to be lost. You don't know your neighbor and this cultural disincentive is removed.

There was a very charming article a couple of weeks ago in the <u>New York Times</u> -- I don't know if any of you have seen it -- on the Albanians in New York. The Albanians had the first Albanian Catholic Church in the world. There was a whole discussion of the Albanian community. Apparently Albanians in New York are invariably very poor. They're real slum dwellers. Yet none of them are on welfare for the simple reason -- as one Albanian American leader put it -- "Albanians do not beg and to Albanians, taking welfare is like begging on the street." Period! So since to the Albanians being on welfare is like begging on the street, they just are not on welfare, even though their income level is much lower than that of the average population. The same goes for the Chinese Americans who are generally poor but almost none on welfare.

But I'll get back to the welfare question a little bit later. At any rate, the negative income tax, by making the bill automatic, I contend, opens the floodgates to an enormous increase, an accretion of people living on production. Here I'd recommend Henry Hazlitt's critique of the negative income tax in THE FREEMAN about four years ago -- July 1966. In the first place, what's obviously going to happen if the negative income tax is put in, is that the floor, which Friedman sets at essentially $1,500 a year -- it's $3,000 with 50% off so it amounts to $1,500 a year -- will obviously start increasing to beat the band at a very rapid rate because the first thing people will say is "Well, $3,000 is officially considered by the government as the poverty level for a family of four and you can't subsidize people, have a guaranteed income <u>below</u> the poverty level. So, therefore, we have to raise it immediately to $3,000 from $1,500." That'll be the first outcry. Secondly, of course, there will have to be cost of living increases every year because there will be inflation every year and this will add on to the floor. And thirdly, of course, the welfare client organizations are already demanding their so-called "right" to a guaranteed $6,000 a year income. So the hopped-up pressure to keep raising the floor almost indefinitely is already under way, even before the thing has begun. So it's pretty obvious this floor, starting at a fairly reasonable looking $1,500, is going to skyrocket very quickly. That's a fairly obvious point, but there's another point.

The other point is, who will continue working? Now, which person who gets below the floor will keep working? I would maintain very few people. In other words, if the floor is $3,000 a year, there'll be very, very few people who will keep working at $2,500 a year if they can just simply quit, work zero hours a week, sit on the porch and get $3,000 from the government instead of getting $500 from the government. If you see the current estimates of the costs of a guaranteed annual income, the costs all look fairly reasonable -- $5 billion a year, $10 billion, $15 billion. It doesn't look catastrophic. However, these costs are all based on the assumption that everybody will continue working in the same way they're working now. The disincentive effect, it seems to me, will be catastrophic from this sort of thing and this is not taken into account.

If the floor is $3,000, I contend everybody below $3,000 will quit pretty quickly. If they don't quit, they are pretty screwy. They'll quit! A person getting $3,000 will quit. How about people getting above $3,000? Well, they're going to quit too. Because if you're getting say $3,500 a year, it means you're working 40 hours a week in order to get $500 a year. That's not very much. So I think people will quit work en masse, up to at least say $4,000 -- maybe $5,000 a year, something like that. And as they quit, this will mean an enormous number of people flooding onto the dole. Somebody has got to pay for this and, of course, the person who pays for it is the taxpayer. This means taxes have to be increased very sharply on the guys who are still working -- the guys getting above $5,000 a year. And as the taxes are increased on them, their after-tax-income goes down maybe to $4,000, $3,000. So they start quitting. As they start quitting this floods the rolls some more and heaps more taxes on those who continue to work -- maybe those above $6,000 and then they start quitting. So what I'm saying is that I envision, with the guaranteed annual income, a viscious spiral upward or downward or whatever and we wind up with everybody on the dole -- nobody working. Even the Keynesians can't really cope with that kind of assistance. I just foresee a total disaster if this thing comes into effect.

Also, just as another extra sort of tidbit on this. The Friedman dole -- in addition to the present point that the Friedman dole is automatic -- increases the subsidies per kid, per welfare kid. In other words, a family of eight people, six kids, seven kids, or whatever, gets a lot more proportionally than a person with two kids. If you're paying people per kid it means it subsidizes the kid population. In other words, especially it subsidizes the kid population among the poor, the very people who should have less kids, not more. Now I don't buy this present hysteria about the population bomb, the population explosion -- we should all commit suicide in order to stop air pollution and all that sort of thing -- I don't go along with that. But surely, we shouldn't be deliberately subsidizing more kids among poor people. That seems a very peculiar kind of system. But here again, Friedman's negative income tax would do this, as an automatic right, don't forget! In other words, you couldn't talk with persons and say maybe you should have a few less kids, or something like that. This would be considered -- and it would be in fact -- an intrusion of their privacy.

So therefore what I'm saying is that it's not true that the Friedman plan, as many conservatives say, would be better at least than the current system, although not ideal. What I'm saying is it would be much, much worse than the current system, precisely because it would be "efficient," an automatic, guaranteed sort of thing. And this, incidentally, is an example, it seems to me, of Friedman's general penchant for making the existing system more efficient and by doing so making it much worse. This is just one example of this.

Also, of course, another point, is that in practice, Friedman wants a negative income tax to replace all current welfare systems, to abolish the entire patchwork of welfare programs and substitute the negative income tax. In practice, what's going to happen, as we see it is already happening in the Nixon program, is that the guaranteed annual income will be added on top of the current welfare stuff. It won't replace anything. Nobody is going to get rid of free lunches for blind mothers and that sort of thing. Nobody! All that's going to stay and on top of that we're going to get the guaranteed annual income.

When the Social Security proposal first came in, the big talking point, one of the big talking points in the Social Security proposal in the 1930's was "Look, here we have a patchwork of existing hodgepodge of inefficient state old age relief programs -- different states paying different amounts -- it's all very peculiar and bureaucratic. Why don't we have a very efficient Social Security System at the federal level and make each person pay for his old age relief and that's it? Then we can abolish old age relief, and the thing will be less costly to the taxpayer than before." That was a big economic talking point.

Of course, what happened in practice was that not only the Social Security cost continued to rise astronomically but old age relief itself is much higher now than what it was in the 1930's. In other words, nobody abolished state old age relief. They simply added the Social Security on top of the old programs. This is obviously what's going to happen to the negative income tax.

Also, of course, I think it's pretty clear that the so-called requirement of the Nixon program -- this has nothing to do with Friedman at this point but simply Friedman in action is what the Nixon program really is -- the conservative "requirement," is that all able-bodied recipients of the thing have to go to work and to get a job. This is obviously a phoney. Nobody is going to enforce it. It will be just as unenforceable as the current requirement. Nowadays, in order to get unemployment insurance, relief, unemployment benefits, you're supposed to have to work at whatever the employment service sends you to. Of course, it's obviously a phoney. I don't know of any case of anybody who's really been forced to work on this basis. The requirement, of course, is that you have to work at a <u>suitable</u> job -- or a job you <u>consider</u> suitable, of course. If you don't consider any job suitable, well that's that! It's fairly simply. The whole thing is obviously just a sop-the-conservative-work-requirement to sugarcoat the guaranteed annual income program.

Another point also about the handicapped people on welfare -- some Chicago people have done some good work on this, I must say -- is the idea that an automatic welfare dole reduces the marginal incentive for a handicapped person to invest in his own vocational rehabilitation because it means that the net economic return he gets from being rehabilitated is much less. It might even disappear altogether if you put him on an guaranteed income. As a result of that -- and Estelle James has done some pretty good work on the quantitative importance of this policy -- the welfare program and the negative income tax program tends to keep people handicapped. In other words, it tends to subsidize them to continue to be handicapped, instead of being rehabilitated. As a matter of fact, in general, the whole problem of welfare dependency will be aggravated by the Friedman plan because, once again, they will consider this as an automatic right instead of simply something which they might get or might not get.

The proper solution it seems to me of the whole welfare question is the libertarian solution which is voluntary welfare rather than governmental welfare altogether. The key here is to promote the idea, which of course almost inevitably has to accompany voluntary charity since voluntary charity has a limited budget, of encouraging self-help among the recipients. In other words, the idea of help becomes then the idea of helping people to help themselves, to get them on their feet so they can become productive and off the charity rolls. And this principle is the principle of a famous charity organization society in 19th century England which was extremely effective. It was the famous laissez faire principle of the time. Again the point that I raised about the Albanians and Chinese is going to come in here because the point is that if people begin to adopt the values of self-help and independence they will get off the welfare rolls. Also this is a tremendous reinforcement of this, and we reinforce these particular values by abandoning government programs and encouraging voluntary programs. For example, the Mormon Church I understand is very successful. No Mormons go on welfare either and the Mormon Church has a very successful voluntary welfare program which gives members help in order to get them on their feet. And apparently they're very successful in doing this.

Okay, I just also want to say in passing about the negative income tax -- the whole idea of it, the reason why Friedman falls for it in essence is because it stems from the old Chicago position of being in favor of compulsory egalitarianism, or equalization of incomes. You know, this is again the Simons position, more or less in favor of smashing all, taxing everybody above a certain level and paying everybody below that level. Now Friedman doesn't go that far. But the point is there is still this hangover or remnant of that tradition in separating the micro and the macro. In other words, the idea is the Alfred Marshall, 19th century England position, the general Anglo-American tradition. You've got the "micro" over here, where individual prices are determined by individual supply and demand -- that's one sphere. Then you have the "macro" sphere over here where total price level is determined by the money supply. And these two things never really meet. You have the "macro" out there and the "micro" out here, and that's it! There's no integration. And so the real hidden assumption here in the Friedman position is that you can tax people really as much as you want and it doesn't interfere with their incentives because their incentives are determined by marginal productivity and it's a different sphere out there. I'm going to get back to this little separation thing later when I get to money. Okay, that's the negative income tax.

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Now we come to a crucial area where I differ with Friedman -- the whole area of money and business cycles. Incidentally, this is Friedman's major topic of interest. It's the area where he is worst and it is also his major topic of interest. This, incidentally, happens often in the history of social thought, economic thought and everything else. The area on which the particular person happens to be worst, he sort of pushes for his whole life. This is sort of an unfortunate development. At any rate, here again, Friedman is essentially almost completely a reversion to Irving Fisher who wrote, incidentally, around the 1890's to the 1920's.

Fisher's whole monetary approach and his whole business cycle approach, which are very closely linked, are based again on this Marshallian-Anglo-American dichotomy between the "micro" and the "macro." The macro's out there and the micro's out here. Here you have individual prices which are determined by supply and demand. You let those be determined by the free market. This is a heroic concession to the free market. You let individual prices be determined by the free market. And then over there, there's the macro level. At the macro level, ~~you~~ the macro sphere, you have this price level. The price level is determined by the money supply and velocity and there there's a different situation.

Here you have a situation ripe for government intervention according to the Fisher-Friedman position. The idea is that you have a free market in the micro level and you have the government up to its neck in the macro level and you think the two of them will never meet. This whole approach, this artificial separation of the micro and the macro is of course in exquisite contrast to Mises' great achievement which he began in THE THEORY OF MONEY AND CREDIT, an achievement which has still not been incorporated into Anglo-American economics in almost any sense, integrating into one system the monetary and the real sphere, in other words the monetary sphere and the micro sphere.

Fisher wrote a famous article in the 1920's, recently favorably cited by Friedman, called "The Business Cycle as the Dance of the Dollar." It is a very interesting article and I recommend your reading it because it will give you a clue to the whole Friedmanite position which set the model for the whole Chicago business cycle analysis. In Haberler's book, for example he says that the founder of the purely monetary theory of business cycle is Ralph Hawtrey, an English economist. This is true. But Irving Fisher is just as influential, probably more so in the United States. In this theory, the business cycle then becomes a dance, almost literally. It becomes a kind of random, uncoordinated, uncaused kind of fluctuation of the price level. And so the key to the whole thing, the price level, is somehow moving around. This is a defect of the free market, because the free market allows the price level to keep changing in this kind of peculiar, fancy-type manner. The cure then for the business cycle is for the government to step in, take measures to stabilize the price level, in other words iron out the fluctuations of the price level, keep the price level constant and thereby, of course, cure the business cycle because the business cycle is supposed to be a pure creature of these changes in the price level. And this really remains today, despite modifications which I'll mention a little later, the Friedman position as well.

Friedman is looking for some gimmick, some method of stabilizing the price level. This ideal of stabilizing the price level, of keeping the price level constant, is again linked to Fisher's peculiar view of money, his view of the dollar and the franc and the pound and the whole monetary philosophy. According to Fisher, the true role of money is the measure of values -- the idea that money is supposed to be a measuring stick of some sort and the price level is supposed to be the thing being measured so therefore, according to Fisher, the price level has to be constant in order to fulfill money's true function.

I don't want to get into the idea of why you can't measure values and all the rest of it. I just want to point that out. This idea is very different from the Austrian and 19th century position. Now this goal, this idea, this somehow moral ideal of a stable price level is in total contrast to the 19th century approach and the Austrian approach of saying, of hailing, essentially of lauding, the results of the unhampered free market which almost invariably lead to a falling price level because what usually happens in a free market is that productivity increases, the supply of goods increases and the price level falls. Just like TV sets that fall in price from $2,000 to $60 or whatever over the years, this usually happens /in a free market/ for all goods or most goods and services. So Fisher is really standing there in opposition to the system of an unhampered free market in the macro sense -- in other words, the idea of permitting a falling price level. No, No, that's a terrible thing /Fisher implies/; it's immoral; it doesn't measure;

you have to have a stable price level. Okay!

It was Irving Fisher -- and Irving Fisher was extremely influential by the way, politically and economically -- it was his theory and his influence which really provided the main ideological support for the record, the grizzly record that Percy Greaves mentioned last meeting about the inflation in the Federal Reserve System during the 1920's. Benjamin Strong, who was head of the Federal Reserve Bank in New York and the main leader of the Federal Reserve System in the 1920's, was guided by Fisher and Hawtrey in his whole economic theory. He was a member of Fisher's nefarious Stable Money Association which was pushing the idea of the stable price level. And so the idea was that they looked at the price level. And the price level, was represented by wholesale prices and wholesale prices were either constant during the 1920's or they were falling a little bit because of the increased productivity in the economy. So, they said, "There's no such thing." They were looking at the price level and it was falling.

As a matter of fact, these people were advocating more inflation. They said, "It's a terrible thing. The price level is sagging a little bit and therefore we have to pump more money into the system to raise it." This is the Fisherite, the traditional orthodox economics, if you want to put it that way, the "establishment" economics, all during the 1920's. So when people like Professor Mises and a couple of other people warned about the dangers ahead of a recession in economic prices due to the inflation of bank credit, they said, "No, there's no inflation. We're looking at the price level and the price level's falling." Even in 1930, Irving Fisher refused to recognize that any depression really existed. He said, "No, No. That's only a temporary jolt on the stock market. Things will bounce up again any minute." And now in Friedman's well-known book THE MONETARY HISTORY OF THE UNITED STATES which he wrote a few years ago with Anna Schwartz, he imposes his whole Fisherine theory, his Fisherine views upon the American past.

If you look at Friedman's position on the 1920's, he thinks Benjamin Strong is one of the greatest people who ever lived, a great price stabilizer, tremendous. Things began to go wrong only after Strong died and his policies were no longer put into effect. And so Friedman attributed the 1929 depression not to excess inflation which brings about recession. Quite the contrary. He attributes it to <u>insufficient</u> inflation. He attributes it to the Federal Reserve System's not inflating enough in late 1928, 1929 and not inflating enough surely <u>after</u> 1929. In other words, during the recession they should have inflated much more. They only inflated a little bit and they should have inflated a tremendous amount and this would have solved the whole problem.

So, while it is true that we monetary malinvestment people have to hail the fact that Friedman has brought money into discussion at last, after 30 years of its being ignored by the Keynesians who talk only in terms of expenditure, government expenditure, and so forth, after hailing this, and after saying, "Yes, it's a great thing that money is now back in style, so to speak, back in fashion," we're going to have to record the fact ~~is~~ that Friedman has the exact opposite of the correct theory on money. It's true he talks about money a lot. But the theory is the reverse of the correct one because, as I say, he holds that the stabilization of the price level is the goal of macro policy and therefore Strong was right and his successors were wrong for not inflating enough.

During 1930, after the depression hit, the Fisher view and the Chicago position -- Knight, and Simons, and all these people at the University of Chicago -- took the position that the way to cure the depression was to "reflate" the price level back up to the 1920 level. In other words, somehow keeping the price level constant was no longer good enough. You have to raise the price level back up to the 1920's, doing it in two ways -- (1) by the Federal Reserve System's expanding the money supply through the usual methods and (2) by government deficit and public works programs, expanded public works programs. If you read the literature of the early 1930's, Fisher and the Chicago people -- Knight, Hardy, Simons and so forth -- were considered pretty leftist -- they were considered sort of socialistic because they were in favor of big government deficits, inflationary programs, public works and so forth. And indeed they were. In short, during the early 1930's, Fisher and the Chicago School were pre-Keynesian Keynesians, having the entire Keynesian position without the Keynesian theory behind it. They had another theory behind it, but they had a political program which was virtually the same. As some journal article recently said, the reason why the Chicago School was immune to the Keynesian revolution when it finally hit was that the Chicago people were Keynesians anyway. It wasn't a big thing to them -- inflating the money and expanding deficits, and so forth -- so they didn't buy the whole Keynesian theoretical apparatus as the other people did because they already were Keynesians politically. They favored the compensatory monetary fiscal policy, and so forth, although they always stressed money as more important than fiscal policy, but they had really both arms of it.

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Now, of course, we know about Friedman's famous position in calling for a continuing steady expansion of the money supply by 3% to 4% a year. He changes the percentages every once in a while. He's a little vague about what percentage he really wants -- somewhere between 3% and 4% per year -- to be expanded by the Federal Reserve System. We know that is his position. But what many of us don't realize is that this is simply a continuation of the older Fisher-Chicago policy with a modification where he realized the older policy didn't work very well in practice. In other words, Friedman now says that compensatory fiscal policy doesn't work too well and the compensatory fiscal policy doesn't work too well because it suffers from these inevitable time lags. You look at the statistics and you see there's a recession in January, let's say. First of all it takes about three to four months for the statistics to come in. You don't know what's going on until four months later. Then it takes about six months to decide on what to do. And after you decide what to do, it takes about six to seven months before the effects take place in the economic system. So it's about a year or a year and a half between the time you see a crisis develop and the time when the actual policy to counteract the crisis really takes effect. By that time you are usually in a different phase of the business cycle. You are trying to pump in money to counteract a recession and you wind up pumping in money to aggravate a boom and vice versa.

Friedman apparently realizes, in facing reality, that we cannot stabilize the economy in the short run. You can't have a fine tuning of the system. What he wants to do is to stabilize the price level in the long run, in other words over the long period. The supply of goods and services goes up something like 2% to 3% per year. Therefore, if we pump in an increase in the money supply by 2% to 3% per year, we'll get in the long run a stable price level. This glorious idea of a stable price level will be fulfilled in the long run. So, therefore, Friedman is really, to put it very plainly, simply an inflationist, although a more moderate inflationist than the Keynesians. I'll certainly concede him that.

In the current period, the period of the Nixon administration, Friedman is playing a very pernicious role. What happened was that finally by June 1969, after the Nixon administration had fumbled around for quite a while, they finally stopped increasing the money supply. The happy day finally arrived -- the first time in God knows how many years -- when the money supply was no longer being increased. As soon as that happened, almost to the minute, Friedman and his disciples immediately launched an hysterical campaign attacking this thing. "No, no, it's a terrible thing. We'll get a recession if you don't increase the money supply immediately. Increase it by 3 to 4% per year. Don't keep it constant." And so forth and so on. Finally, after months of this, around February, I'm afraid Friedman's campaign bore fruit, and and we have begun to loosen up the money supply once more, even though prices are still going up at an annual rate of about 5%. So it's hardly solved anything. Because of Friedman's happy role in the situation we now have inflation once again.

What Friedman doesn't understand is the same thing that Fisher didn't understand 40 years ago. It's still part of the same struggle. What he doesn't understand is the insight that Professor Mises' so-called Austrian business cycle theory provided. What he doesn't understand is the insight that finally integrated the monetary sphere and the real sphere and said very simply: When you expand credit, this distorts the structure of production. In other words, it distorts relative prices and so distorts production. It leads to overinvestment in the higher orders of production, in the capital goods sphere and underinvestment in consumer goods. Therefore, the Friedman people along with the whole Anglo-American tradition thinks that inflation doesn't cause any maladjustment of that type, that it simply raises prices, that it simply raises the price level. However, since we know, as Austrians, that it distorts the price level, leads to wasteful malinvestment and overinvestment in the capital goods sphere, as Mises and Hayek have shown, this means that the malinvestment generated by the boom has to be liquidated, must be liquidated. Once the boom and its wasteful investments have been launched, the recession becomes not only inevitable but it performs a very healthy role, performing the function of cleansing the economy of this wasteful malinvestment, getting us back to free market production. So, therefore, according to Austrian theory, recession is a healthy consequence of the evil malinvestment, so to speak, generated by the inflationary boom. What the government policy should be is not to do anything -- in other words, first of all to stop the inflation if you're inflating and if you're in a recession, allow the recession to run its course as quickly as possible because the more quickly it runs its course, the sooner we get back to a healthy economic situation. So this means that the Austrian prescription is the exact opposite of both the Keynesian and the Friedman prescriptions for recession -- not to inflate more, not to keep inflating at 3% to 4% per year but stop inflating! Period! And to keep stopping it!

The problem here again, is that Friedman just like Fisher 40 years ago, really has no business cycle theory, no conception of why a boom leads to a bust. It's all sort of a random fluctuation, a random dance of the dollar and therefore no conception of the healthy function the recessions perform. And so he simply says: "Well, if there's a recession, you pump money in. If there's too much of an inflation, you stop pumping money in." This is a very simplistic view of the business cycle.

Incidentally, I should also say here that Professor Mises' theory is the only theory so far as I know that has ever been coined which explains this phenomenon which we've gotten into in the last couple of years, which has really hit us during this recession -- the phenomenon of prices going up, consumer goods prices going up, with recession and unemployment at the same time. This is the famous sort of scissors effect. This phenomenon, of course, puts the "establishment" economists in a real bind, because all the "establishment" knows, whether it's the monetary establishment or the fiscal establishment, is that if it's a recession you pump money in or spend more, and if there is an inflation you stop pumping money in and take some money out. What do you do if both are happening at the same time? What do you do if consumer goods prices are going up and at the same time there are business failures and unemployment and all the rest of it?

At one time during the 1958 recession, I had the occasion to attend a lecture of Professor Burns, who in those days was head of the Council of Economic Advisors. At that time this phenomenon had appeared already, so I asked him this question: "What would you do, or what would you recommend doing in this situation?" He said, "Well, don't worry about it because we're getting out of the recession very quickly. In a couple of months it will all be over." "Okay. I'll concede that. But what happens if at some future time we don't get out of it very quickly. Then what?" What he said then has stayed with me ever since. He said, "In that case we'll all have to resign." So I'm calling upon him and the rest of the people out there in Washington to resign to fulfill this role. Resign post haste.

Actually, of course, consumer goods prices always did rise during a recession. The only thing is none of us knew about it. None of us really cared because all prices, prices in general, were falling because there was a monetary deflation. In every pre-war recession, pre-World War II recession, the money supply would fall and prices would fall. Consumer goods prices wouldn't fall as much as the other prices and this would perform the same function, the same role. Consumer goods prices would rise relative to other prices but obviously nobody worried about it. Nowadays of course with our new modern, developed, scientific system we don't have any deflation anymore. It's impossible. Government's arranged the banking system in such a way the money supply can never, ever fall. And so we don't have prices falling any more. So we have a phenomenon in a recession of consumer goods prices starkly going up. It has upset everybody, as well it might. Now the reason for this,the reason why consumer goods prices go up during a recession, again has been explained by the Austrian theory, by Professor Mises' theory. This is that during a recession resources have to shift from capital goods to consumer goods and reflect this higher consumption investment ratio which the economy had been working on. In doing that, resources shift from capital goods to consumer goods. Consumer goods prices go up and capital goods prices go down, reflecting this different shift of demand and supply. This, as I say, has always been taking place. It's only now that it has been starkly revealed. Now that we've been saved from deflation, it has been starkly revealed. We get the worst of both worlds now in the current, scientifically-organized recession. We have prices going up and unemployment.

And of course another thing is that Friedman again really has a very mechanical, mathematical statistical approach. He tends to ignore the fact that the demand for money is not really stable. It varies. It varies really in accordance with expectations of prices going up. Professor Mises has talked about the various stages of inflation. We have ~~in~~ the first stage when people think that prices will go back to normal pretty soon. It's the old naive days, prices going up while its purely war-time or something. People expect prices will go back soon. We've abandoned that stage. Now the public has begun to realize that prices will keep going up forever. Every year we have a 5% incrase, or something like that. Once they begin to realize that, the demand for money will fall drastically and prices will begin to really skyrocket. We are just about at that point. We are just about reaching stage two in this inflationary process. This is something Friedman really doesn't take into account. He doesn't take subjective expectations very much into account -- it's all kind of a mechanical theory. You have function; you have statistics; it's all correlated; and that's that!

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Okay. Now to get to the last big part -- again on monetary policy, fiat versus commodity money. Here is another criticism I have of the Friedman position. One of the reasons that Fisher and the Chicago School in the 1930's were considered to be radical was because they were always against the gold standard, always chafing under the strength of the gold standard. Friedman, of course, frankly wants to abolish gold altogether as a monetary commodity and replace it with totally fiat currencies. The dollar will be totally fiat, also the franc, the mark and so forth, and so on. All of these currencies are supposed to fluctuate freely in relation to each other. Now with this change -- again supposedly this would be more efficient than the present system -- you won't have to worry about the balance of payments all the time. There wouldn't be a pound crisis every two years, and all the rest of it. It would be more efficient in the sense that the exchange rates would then fluctuate in accordance with the monetary issue of each currency. However, even though it would be more efficient,it would be a lot worse. For one thing, it would cut completely every tie to gold, every tie to a commodity money we have now, as weak as the tie is. For one thing, at least now we have this check on the government. They can't inflate too much because the balance of payments would be pretty embarrassing. Gold would keep going out, and that's kind of an embarrassing situation. So at least this has provided a fairly good check on the government in the last few years on inflation.

One thing that Friedman, of course, doesn't realize is that the government is not sort of a neutral agency, not sort of a neutral instrument for social action. Essentially the Chicago position is that government is sometimes efficient, sometimes inefficient. You sort of take the thing on an ad hoc basis. But government is essentially, inherently an inflationary instrument. In other words, my contention is that the inherent tendency of the state is inflationary. If you give to the state, to the government, without any check at all, without the gold standard check, the total power to inflate money at will, they're going to do it. They're going to use it for reasons I'll say in a minute. So what Friedman advocates is to leave the total absolute, dictatorial control of the money supply in the hands of the central government without any check, without any commodity money check, without any international money at all, placing all power in the hands of the government and then trusting the government, urging it to bind itself by these 3% or 4% per year rules. They're not going to do it. It's just Utopian, unrealistic and kooky to expect that the Federal government is going to do this -- first get total power and then hardly use it. I think we know about power by this time in the 20th century. We know that this sort of thing isn't done.

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The critics of the gold standard all say that those of us who are in favor of the gold standard are sort of gold fetishists -- we like to stay in the closet at night and run our hands through our gold coins. "Ah, gold!" And that sort of thing. That's a lot of nonsense. Unfortunately I've never seen a gold coin. I'd like to. The great thing the major point, main reason why we're in favor of the gold standard is because gold is a commodity money. It's costly to get it. In order to get it you have to dig it out of the ground and that costs a lot. You have to produce it, sell it, and so forth. This is all costly -- to discover and mine it -- and this creates a market check, an automatic market check on the government tendency toward inflation, whereas fiat paper, government paper, doesn't have this check of high cost, and so forth. It's very easy, it's almost costless to print money.

Also, another point -- I think a very important one -- that is money is really a key command post of the entire economic system. Money, of course, is used in every exchange. Every transaction has money as one part of it. So money is the most important single commodity and he who controls the money supply is a long way toward controlling the whole economic system, regardless of whether you say, "Yes. Well we're in favor of the free market but against any intervention except in money." So if you allow intervention in money you've really got the whole system in your hands anyway. As I say, Friedman would not only leave this power in the hands of the state; he <u>welcomes</u> it; he's in favor of it. He would sort of <u>shove</u> the power in the hands of the state, this unlimited power to print money.

The state printing of money and of course of the bank credit based on the whole controlled banking system which is really a government operation by this time, this whole system, is really nothing more nor less, I think very bluntly, than simply legalized counterfeiting. Now the reason why I think the inherent tendencies of the state is inflation is simply this. Suppose you or I or anyone of us or any group of us were given absolute power and somebody came to us and handed us a printing press and said: "Okay, you guys from now on have complete control of the printing presses. You have a compulsory monopoly of the printing press. You can print whatever you want, whatever money you want. You can use it for any purpose. Anybody else who prints it gets shot or gets 30 years in jail." What do we do with it? We use it. We print money with it. I think it's inevitable. And this is what happens with the government.

The government has allocated, or arrogated, to itself the compulsory monopoly of the use of the printing press and so they use it. The thing is as simple as all that. And they use it more and more. It's very easy. You don't have to work. You make money without working for it, without even taxing for it. Working is a kind of a pain in the neck and taxing is kind of onerous and a pain in other people's necks and they start complaining. Printing money is very simple. Nobody knows about it. It's sort of done in the dark of night. Nobody understands money, monetary theory, really anyway. They understand taxes. They don't understand monetary theory. So it's a very easy, ready thing to do. When the state inflates the money supply and then six months later, a year later, prices start going up, the state can always blame other people, everybody else gets blamed. This, of course, is characteristic.

Speculators get blamed, businessmen, unions, consumers in general. We all know about those monsterous commercials -- inflation is caused by all of us because we're piggy, we are all evil, we like to eat, everybody is to blame, so don't be piggy! Everybody under the sun has been blamed in the past year except the government itself. Government is a shining knight in armor manning the ramparts, always checking inflation, and so forth, and so on. Actually, of course, they're the ones who are doing it, they're the ones who are inflating.

Gold also provides an international money, another I think important point. It provides the money for world markets which we hope someday, at least, will come into being -- a world division of labor, free trade and so forth. An international money is really the basis of it.

The Friedman idea is that each government prints its own money without any kind of world balancing out in world money. The logic of this doesn't seem so absurd if you look at a hundred countries, each one printing its own money. A hundred currencies isn't so bad. What happens if you pursue the logic of it a little bit further? What happens if every province, every state, every county, every borough, every municipality, every little village, printed its own money? I don't mean that it just has a printing press, but it actually prints its own currency? This would mean that the city of Plainfield prints Plainfieldiana notes, or whatever. They print 8 Plainfields a week, or something like that. Each block can print its own money, each house, each person even. I'll print 10 Rothbards. They wouldn't be worth very much. But the point is, if you have this kind of situation, this would really be chaos. People accuse the market of being chaos; this would really be chaos. You would have millions of exchange rates all over the place. You would have to consider what 10 Rothbards would be worth in terms of 80 Plainfields, and that sort of thing, in addition to trying to figure prices. So what you really have in this kind of system is a breaking up of money as a general medium of exchange, which is what money is supposed to be. Money is supposed to be a commodity which everybody uses in exchange. Instead of that you would have every little locality printing its own money. You would have the breaking up of a price system, a crippled price system, really a chaotic situation -- I don't think there's any question about it.

The Friedman plan is logically similar although not quite as absurd because it's quantitatively not as bad. Under the Friedman plan you are dealing with only 120 governments, instead of two million, but the principle is still the same. You're still breaking up the world market. You are still ending the days when you had one commodity or two commodities -- gold or silver -- being used by every country, which provided a world money for everybody. And you're busting up the international division of labor and so forth.

Again, I think Friedman arrived at this idea of fluctuating fiat money because he, just like Fisher 40 or 50 years ago, doesn't understand the true nature of money. They think of money as simply a name. The name is there. The money is the "dollar," the "franc," or whatever. They don't understand that money is really basically a commodity. These currencies are units of weight of gold or silver. That's how all these names originated, where the names come from. People didn't sit down one day in 1790 and say, "Okay. From now on we call our money "dollars" and we start printing them." Dollars were units of weight of gold or silver. Similarly there were silver francs, silver pounds, and so forth. As a matter of fact, even now, even in this benighted age, if you look at the statutes of the United States you see what the "dollar" is defined as. A dollar, it says, is defined as being one 35th, approximately, of a gold ounce. In other words, that is the definition of a "dollar." So even now, when we're far from a true gold standard, these currencies are still defined in terms of units of weight of gold. It was characteristic that Fisher's beloved colleague, J. Shield Nicholson, distinguished economist, wrote a book in which he said that money is essentially like dodo bones. In other words, he tried to pick the most useless commodity, the most useless thing he could think of, dodo bones. Money was like dodo bones, really useless, just a name, and so forth. Friedman is carrying on in that tradition.

I admit that economic theory doesn't decree that a certain given commodity must be money. It could be gold. It could be silver. It could be platinum. It could be something else. The point is that we are now in a specific historical situation. The gold <u>was</u> our money before 1933 and then it was seized from us, confiscated. I keep mentioning this. Nobody seems even perturbed about this point yet it seems to me a rather important one. We were using gold coins before 1933. The government confiscated the coins under the guise of this being necessary to save the banks during the special crisis, the depression emergency. Well, the depression emergency has been over for at least 30 years, maybe 38, and nothing has been done about what we're talking about here. Not one step has been made to return the gold to us, now that the emergency is over. Of course, it's characteristic of government to pass emergency legislation and then let it linger on forever as part of the "American tradition." But where is our gold? The banks have been saved. The depression emergency is over. Yet the gold continues in the hands of the government. It seems to me the libertarian monetary policy, in addition to not inflating during inflations and recessions, must be first and foremost to get the gold back to us. Make the government disgorge the gold, which it stole from us and return it to us. It is fairly simple, as simple as that. In exchange for the paper they unloaded upon us, we want the gold back. So it seems to me the libertarian must call, not like Friedman for cutting money loose totally from gold, but for the restoration of gold to us as the free market money, the people's money or whatever slogan you want to bring to it.

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And so, in conclusion. On some of the most vital economic issues of our day, Milton Friedman stands in flagrant opposition to economic freedom. His "neighborhood effect"makes a crucial concession which in other hands can and does justify almost any type of government intervention in a market economy. His negative income tax proposal has in the name of efficiency, paved the way for a disastrous measure, the guaranteed annual income that bids fair to wreck our entire economic system. His monetary views, seemingly close to ours, actually provide a rationale for an open invitation to inflation as well as an apologia for total governmental control of the money supply. Finally, Milton Friedman stands athwart our path balking us when we call for restoration of the gold money that was stolen from us in the depression emergency. In all of these crucial cases, Friedman stands in direct opposition to libertarian solutions and a libertarian policy. No, Milton Friedman is not our leader!

Thank you.

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There were several questions but the answers to only two contributed anything significant to what Murray Rothbard had already said in his talk.

Q. Wouldn't you say if the inflation were continued at a steady annual rate -- as a matter of fact you have this right now -- wouldn't we have something which is a recession with rising prices? And if you continued the inflation now at the same rate as before, the recession wouldn't go back to a boom. You would simply have a long-range continuing recession so that, in a sense, the addictive effect of the inflationary policy we have had up to now would require the government to continue to expand the inflation at an ever greater rate in order to maintain the boom? Thus, wouldn't Friedman's theory of 3% per annum fail to accomplish the purpose of eliminating or flattening out the business cycle? The only way you can do this, considering the malinvestment problem, is to increase the rate of inflation so that eventually it reaches a point where it is 10%, 15%, 20%, 30%, 40%, 50%, and so on, and where people don't even have any use for money.

ROTHBARD: That is a good point. I should have mentioned that. You have to keep accelerating the rate of inflation in order to keep the same level. It is like a treadmill. You keep going faster and faster in order to keep the same pace.

GREAVES (NC): WHAT these folks don't recognize is that the one time we came nearest to their goal was in the period of 1927-1928. And that is what brought on 1929, so that if they achieve what they are seeking to achieve, they would blow the whole thing.

Q. If "we" were as smart in 1929 as we are now, would a continued expanding inflation on the part of the Federal Reserve System have prevented the depression and put us into a long-range rising inflation instead, something like Germany had in 1922-1923?

ROTHBARD: It is possible. It is very difficult to know. We were hindered then because of the fact we were on the gold standard and gold was flowing out rapidly. And banks were collapsing. Don't forget, banks in those days were a part of the market system so that banks were folding pretty often. That was before the days of bank deposit insurance which, incidentally, Friedman loves. He thinks it is the greatest single innovation in the banking system. I should have mentioned that. Actually, it is a monstrous system of bank insurance which gives the banks carte blanche. The government underwrites every deposit up to $10,000 or $15,000, so that nobody thinks the banks are unsafe. And that's it! The banks are given a blank check. In those days, the banks were collapsing pretty quickly. People would line up in the morning, at 6:00 in the morning, to try to get their money, to withdraw their deposits, and this precipitated bank runs. You had to do as Roosevelt did, throw out the gold standard, impose bank deposit insurance, completely renovate, state-ize the banks, before you could have the current inflation.